CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

September 20, 2007

H.R. 3121
Flood Insurance Reform and Modernization Act of 2007

As ordered reported by the House Committee on Financial Services on July 26, 2007

SUMMARY

H.R. 3121 would authorize the National Flood Insurance Program (NFIP) of the Federal Emergency Management Agency (FEMA) to enter into and renew flood insurance policies through 2013. Under current law, that authority would expire at the end of 2008. The legislation also would increase the amount that FEMA can borrow from the U.S. Treasury to cover expenses of the NFIP from $20.8 billion to $21.5 billion. As a result, CBO estimates that enacting H.R. 3121 would increase direct spending by $725 million in 2009.

By raising certain civil penalties on lending institutions, CBO estimates that the bill would increase revenues by $1 million per year. Finally, H.R. 3121 would authorize the appropriation of nearly $2.8 billion over the 2008-2012 period for mapping regions of the country at risk of flooding and for other activities. CBO estimates that implementing those provisions would increase discretionary spending by about $1.8 billion over the 2008-2012 period, assuming the appropriation of the specified amounts.

H.R. 3121 would require FEMA to phase in actuarially sound flood insurance premiums for owners of certain commercial properties and some residential properties that are not the owners' primary residences—if they do not currently pay actuarial rates for flood insurance. The legislation also would authorize FEMA to offer new types of insurance coverage (including multiperil insurance for floods and windstorms) as well as increase the maximum insurance coverage available for structures and their contents. Moreover, H.R. 3121 would raise the cap on the average annual premium increase allowed under current law from 10 percent to 15 percent. CBO estimates that enacting those provisions would have no significant net effect on direct spending over the 2008-2017 period. (The increases in premiums would yield an additional $3.1 billion in receipts over that period, but they would have to be spent to cover the NFIP's ongoing costs.)

H.R. 3121 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments.

H.R. 3121 would impose a private-sector mandate, as defined in UMRA, on certain mortgage lenders. Based on information from FEMA and industry sources, CBO expects the direct costs to comply with the mandate would be small and fall below the annual threshold for private-sector mandates established in UMRA ($131 million in 2007, adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 3121 is shown in the following table. The costs of this legislation fall within budget function 450 (community and regional development).

	By Fiscal Year, in Millions of Dollars				
	2008	2009	2010	2011	2012
CHANGES IN DIRECT SPENDING AND REVENUES [a]					
Additional Borrowing for Flood Insurance					
Estimated Budget Authority	0	725	0	0	0
Estimated Outlays	0	725	0	0	0
Estimated Revenues	1	1	1	1	1
CHANGES IN SPENDING SUBJECT TO APPROPRIATION					
Flood Mapping Program					
Authorization Level	400	400	400	400	400
Estimated Outlays	100	260	340	400	400
Outreach Grants					
Authorization Level	50	50	50	50	50
Estimated Outlays	28	40	50	50	50
Mitigation of Severe Repetitive Loss Properties					
Authorization Level	0	0	40	40	40
Estimated Outlays	0	0	12	36	40
Additional Studies					
Authorization Level	1	0	0	0	0
Estimated Outlays	1	0	0	0	0
Total Changes					
Authorization Level	451	450	490	490	490
Estimated Outlays	129	300	402	486	490

a. CBO estimates that there would be no changes in direct spending after 2012 under H.R. 3121, and that revenue collections of $1 million a year would continue after 2012.

BASIS OF ESTIMATE

For this estimate, CBO assumes that H.R. 3121 will be enacted near the start of fiscal year 2008 and that amounts specified by the bill will be appropriated for each year. We estimate that enacting H.R. 3121 would increase direct spending by $725 million in 2009. In addition, CBO estimates that implementing the bill would increase discretionary spending by about $1.8 billion over the 2008-2012 period.

Direct Spending and Revenues

CBO estimates that the bill's increase in FEMA's borrowing authority would result in new direct spending. Other changes to the flood insurance program would affect operations of the program, but we estimate that those changes would not result in any significant net impact on direct spending over the next 10 years.

Increase in Borrowing Authority. Through the NFIP, FEMA offers flood insurance in communities that conform to the program's standards for flood plain management. Under current law, if premiums from policy sales and interest income are insufficient to cover the program's costs, FEMA can borrow up to $20.8 billion from the U.S. Treasury. As of August 2007, the NFIP had borrowed a total of $17.5 billion (the bulk of which has been used to settle claims related to Hurricanes Katrina and Rita). Based on information from FEMA about outstanding claims and continuing interest payments on its past borrowing, CBO expects that the agency will exhaust its remaining borrowing authority within the next few years. Section 12 would increase FEMA's borrowing authority for the flood insurance program by $725 million. CBO estimates that the agency would exercise this authority in 2009, resulting in an increase in direct spending of $725 million in that year, relative to current baseline projections.

Current law requires FEMA to repay any borrowed funds (with interest) as it collects premiums, provided that the program's other costs are fully covered. However, CBO expects that the agency would be unlikely to repay funds borrowed under H.R. 3121 within the next 10 years. Based on historical data, the agency is likely to face claims of between $1 billion and $2 billion per year for flooding events around the country (this does not include additional claims that would be filed if another catastrophic event were to occur). Based on the amount of current and projected borrowing by the flood insurance program, CBO estimates that FEMA also will be required to make annual debt-service payments to the Treasury of between $800 million and $900 million. CBO expects that the program will collect insufficient premiums to cover claims expenses and debt-service costs over the next 10 years.

In other words, CBO expects that the NFIP will probably not have sufficient funds to make timely payments for all valid claims submitted to it. By increasing the program's borrowing authority, H.R. 3121 would provide resources—$725 million—to liquidate such claims that otherwise could not be promptly paid under current law.

Civil Penalties. Section 6 would increase the civil penalty from $350 to $2,000 for lenders that do not enforce the purchase and notification requirements for certain mortgagors. Penalty collections are recorded in the budget as revenues. CBO estimates that the increased collections of civil penalties under this bill would total about $1 million a year. The amounts collected would be credited to the National Flood Mitigation Fund and could be spent, subject to future appropriation actions.

Rate Increases for Certain Properties. Section 4 would direct FEMA to increase flood insurance premiums for certain policyholders who currently receive discounted or subsidized rates. Under current law, some property owners are charged a premium that is less than the full actuarial cost of the insurance because they were built before the community's flood insurance rate map (FIRM) was completed (or before 1975, whichever is later). Those properties are collectively known as pre-FIRM properties. (Some post-FIRM policies also receive a discounted premium, but they are few in number relative to pre-FIRM properties.) FEMA estimates the average discount for pre-FIRM properties is about 60 percent.

H.R. 3121 would increase premiums for nonresidential pre-FIRM properties and pre-FIRM properties that are not the primary residence of either the owner or a tenant (for example, vacation homes) to actuarial levels by 2011. The bill would direct the NFIP to assess an additional 15 percent on top of routine annual rate increases for those properties until the actuarial rate is achieved (or until 2011, when such policies would be charged an actuarial rate). Based on information from FEMA, CBO estimates that approximately 375,000 properties would be subject to such rate increases under the bill. CBO expects that owners of some of those properties would either drop flood insurance or reduce their level of coverage in response to an increase in premium charges. However, we expect that any decrease in premium income resulting from a reduction in coverage would be more than offset by increased collections from properties that remain in the program. Additionally, by reducing the number of pre-FIRM properties in the program, the NFIP would save the cost of paying claims on those subsidized policies in the future.

CBO estimates that implementing this provision would increase receipts from flood insurance premiums by about $900 million over the 2008-2012 period and by about $3.1 billion over the next 10 years. Subsidized policyholders that drop flood insurance coverage in response to the rate increases would reduce program costs by an average of $45 million a year over the next 10 years, CBO estimates.

CBO anticipates that any additional receipts generated by increasing premiums on those properties would be spent on future flood insurance claims that the program would otherwise not have the resources to pay—resulting in no significant net budgetary impact. That is, the program changes required under section 4 would improve the long-term actuarial position of the NFIP; but the program's large debt and the requirement to pay interest costs on that debt means that savings from the reduction in subsidized policies would have to be used to cover ongoing costs of the NFIP and would not lead to net budgetary savings over the 2008-2017 period.

Multiperil Insurance. Section 7 would authorize FEMA to offer insurance coverage for flood and wind damage to property owners in communities that conform to the program's standards for wind damage and flood plain management. (Additional standards related to windstorms would be established under the bill based on studies undertaken by FEMA.) Under H.R. 3121, FEMA would be authorized to insure damages attributable to floods or windstorms up to a maximum of $650,000 per residence for structure, contents, and additional living expenses and a total of $1,750,000 for structure, contents, and business interruption losses for commercial properties.

H.R. 3121 would direct FEMA to offer such multiperil coverage at actuarial (i.e., unsubsidized) rates. Because of the uncertain nature of actuarial pricing, FEMA might collect more receipts than necessary to pay future claims (resulting in a net reduction in direct spending). It is also possible that FEMA might collect less premium income than would be necessary to cover future liabilities from multiperil policies, which would likely result in the need for additional borrowing authority from the Treasury. In the latter case, the legislation would prohibit FEMA from entering into or renewing any multiperil policy until such borrowing is repaid. CBO expects that the new coverage offered under H.R. 3121 would increase premium receipts and additional claims payments by about the same amount—resulting in no significant net budgetary impact.

Increased Coverage Limits and New Lines of Coverage. Sections 8 and 9 would increase the total amount of flood insurance coverage available to a residential customer from $350,000 to $470,000, and to a commercial business from $1.0 million to $1.3 million. The legislation would direct FEMA to include coverage of up to $1,000 for living expenses in all future polices. Additional optional coverage also would be available for living expenses, repairs to residential basements and crawl spaces, business interruption, and the full replacement of contents.

As of June 2007, the NFIP had approximately 5.5 million policies in force, with a total exposure of over $1 trillion. Those policyholders pay about $2.7 billion in premiums to the federal government annually. Under the bill, the increased coverage limits and new lines of insurance would be offered to policyholders when they initiate or renew their policies and that coverage would be offered at actuarial rates. Thus, CBO expects that any additional insurance coverage obtained under this provision would increase premium receipts to the federal government, which would—on average—be roughly offset by additional claims payments.

Increase in Annual Limit on Rate Increases. Section 11 would authorize the NFIP to increase rates on policies within a specified risk category by an average of up to 15 percent per year. Under current law, the limit is 10 percent. CBO estimates that raising this limit would have no significant impact on the federal budget because to date FEMA has not been constrained in its rate-setting process by the current cap on premiums for actuarially priced policies. (Rate increases for subsidized policies would be affected by other provisions of the bill.)

Spending Subject to Appropriation

Implementing H.R. 3121 would increase discretionary spending by $1.8 billion over the 2008-2012 period, assuming appropriation of the authorized amounts.

Flood Mapping Program. Section 22 would authorize the appropriation of $400 million per year over the 2008-2013 period for updating flood maps to include the 500-year flood plain, as well as areas that would be flooded if a dam or levee failed. In addition, the bill would reestablish a 14-member Technical Mapping Advisory Council to assist with managing flood mapping activities. Based on historical spending patterns for this program, CBO estimates that implementing this section would cost $1.5 billion over the 2008-2012 period and an additional $900 million after 2012.

Grants for Outreach to Property Owners and Renters. Section 15 would authorize the appropriation of $250 million over the 2008-2012 period for grants to communities participating in the NFIP to conduct educational and outreach activities to encourage the purchase of flood insurance and raise the awareness of flood risk and measures that can be taken to mitigate flood damages. Based on the historical spending patterns of similar programs, CBO estimates that implementing this provision would cost $218 million over the 2008-2012 period, assuming appropriation of the specified amounts.

Mitigation of Severe Repetitive Loss Properties. Section 17 would extend for three years the authorization of appropriations for the mitigation pilot program that funds preventive measures for certain properties that have been frequently flooded (known as severe repetitive loss properties). Severe repetitive loss properties are those that have sustained four or more losses totaling more than $20,000, or two or more losses that cumulatively exceed the value of the property. Under current law, up to $40 million a year from the National Flood Insurance Fund can be used for this program through 2009. Based on historical spending rates for mitigation projects, CBO estimates that implementing this section would cost $88 million over the 2008-2012 period.

Additional Studies. H.R. 3121 would authorize the Government Accountability Office to conduct studies of pre-FIRM properties, the feasibility of expanding the requirement to purchase flood insurance, and potential methods for increasing the participation of low-income families in the NFIP. The bill also would direct FEMA to conduct studies on the impact of using nationally recognized building codes as a part of flood-plain management and the economic effects of eliminating the discounted premiums paid by owners of certain pre-FIRM properties. CBO estimates that preparing those studies would cost $1 million in fiscal year 2008.

Staff Increases. Section 25 would authorize FEMA to hire additional staff to implement the provisions of this bill. The amount of increased administrative costs that would result from the bill is uncertain because FEMA does not yet know how it would implement various provisions. Subject to appropriation of administrative expenses, FEMA is authorized to set an administrative cost recovery fee on flood insurance policies to offset spending on salaries and expenses. Thus, CBO expects additional administrative costs under the bill would not have a significant net cost.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 3121 contains no intergovernmental mandates as defined in UMRA. Assuming appropriation of authorized amounts, CBO estimates state, local, and tribal governments would receive up to $300 million over the 2008-2012 period for outreach and flood mitigation activities. Any costs to those governments would be incurred voluntarily as a condition of receiving federal assistance.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

H.R. 3121 would impose a private-sector mandate, as defined in UMRA, on certain mortgage lenders. Based on information from FEMA and industry sources, CBO expects that the direct costs to comply with the mandate would be small and fall below the annual threshold for private-sector mandates established in UMRA ($131 million in 2007, adjusted annually for inflation).

Under current law, mortgage lenders who make federally related mortgages, as defined in title 12 U.S.C. 2602, are required to provide a good-faith estimate of the amount or range of charges the borrower is likely to incur for specific settlement services. The bill would require such mortgage lenders to include in each good-faith estimate a conspicuous statement that flood insurance coverage for residential real estate is generally available under the National Flood Insurance Program whether or not the real estate is located in an area having special flood hazards and that to obtain such coverage, a home owner or purchaser should contact the NFIP. The good-faith estimate also would be required to contain a telephone number and Web site address by which a home owner or purchaser can contact the NFIP. Finally, the estimate would be required to contain the statement that the escrowing of flood insurance premiums is required for many loans under section 102(d) of the Flood Disaster Protection Act of 1973, and may be a convenient and available option with respect to other loans. According to industry representatives, the cost for mortgage lenders to include the required additional statements in such an estimate would be minimal.

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